SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 33

THOMAS H. WELCH, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 40852

THOMAS H. WELCH, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Taxpayer: P. J. Coffey, Esq., A. E. Horn, Esq.
For Comm'r: C. H. Curl, Esq.

DOCKET ENTRIES

1928.

Oct. 1. Petition received and filed. Taxpayer notified. (Fee paid.)
" 2. Copy of petition served on General Counsel.
Nov. 24. Answer filed by General Counsel.
" 27. Copy of answer served on taxpayer. General Calendar.

1929.

Oct. 3. Motion for circuit calendar for hearing at St. Paul, Minn., filed by taxpayer.
" 4. Motion granted.

1931.

Jun. 5. Hearing set July 14, 1931, St. Paul, Minn.
" 26. Motion to consolidate with 53119 for hearing 7/14/31 at St. Paul, filed by taxpayer.
Jul. 15. Hearing had before Mr. Lansdon, Div. 8 on merits. Briefs due in 60 days.
" 31. Transcript of hearing July 15, 1931, filed.
Aug. 8. Brief filed by taxpayer.
" 15. Brief filed by General Counsel.

[fol. 2]

1932.

Jan. 8. Findings of fact and opinion rendered, Judge Lansdon, Div. 8. Judgment will be entered for the Commissioner.
" 9. Decision entered, Div. 8.

1932.

Jun. 21. Supersedeas bond in the amount of $8,500.00 approved and ordered filed.
" 21. Petition for review to U. S. Circuit Court of Appeals (8) with assignments of error, filed by taxpayer.
Jul. 5. Proof of service filed.
Aug. 6. Agreed statement of evidence lodged.
" 6. Praecipe filed—affidavit of service thereon.
" 9. Agreed statement of evidence approved and ordered filed.

Before United States Board of Tax Appeals

Docket No. 5129

Thomas H. Welch, Petitioner,

vs.

Commissioner of Internal Revenue, Respondent

Appearances:

For Taxpayer: P. J. Coffey, Esq., A. E. Horn, Esq.
For Comm'r: C. H. Curl, Esq.

Docket Entries

1931.

Jan. 12. Petition received and filed. Taxpayer notified. (Fee paid.)
" 12. Copy of petition served on General Counsel.
Feb. 5. Answer filed by General Counsel.
" 10. Copy served—assigned General Calendar.
Jul. 15. Hearing had before W. C. Lansdon, Div. 8 on merits. Briefs due in 60 days.
" 31. Transcript of hearing of July 15, 1931 filed.
Aug. 8. Brief filed by taxpayer.
" 15. Brief filed by General Counsel.

[fol. 3]

1932.

Jan. 8. Findings of fact and opinion rendered, W. C. Lansdon, Div. 8. Decision will be entered for respondent.
" 9. Decision entered, W. C. Lansdon, Div. 8.

1932.

Jun. 21. Supersedeas bond in the amount of $8,500.00 approved and ordered filed.
" 21. Petition for review to U. S. Circuit Court of Appeals (8) with assignments of error, filed by taxpayer.
Jul. 5. Proof of service filed.
Aug. 6. Praecipe with affidavit of service attached, filed.
" 6. Agreed statement of evidence lodged.
" 8. Agreed statement of evidence approved and ordered filed.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 53119

THOMAS H. WELCH, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Taxpayer: P. J. Coffey, Esq., A. E. Horn, Esq.
For Comm'r: C. H. Curl, Esq.

DOCKET ENTRIES

1931.

Feb. 24. Petition received and filed. Taxpayer notified. (Fee paid.)
" 24. Copy of petition served on General Counsel.
Mar. 13. Answer filed by General Counsel.
" 17. Copy of answer served on taxpayer. General Calendar.
Jun. 26. Motion to consolidate with docket 40852 for hearing in St. Paul, July 14, 1931, filed by taxpayer.
Jul. 2. Hearing set July 14, 1931, St. Paul, Minn.
" 15. Hearing had before Mr. Lansdon, Div. 8. Called on merits. Briefs due in 60 days.
" 31. Transcript of hearing July 15, 1931, filed.
[fol. 4]
Aug. 8. Brief filed by taxpayer.
" 15. Brief filed by General Counsel.

1932.

Jan. 8. Findings of fact and opinion rendered, Judge Lansdon, Div. 8. Decision will be entered for the Commissioner.

" 9. Decision entered, Div. 8.

Jun. 21. Supersedeas bond in the amount of $8,500.00 approved and ordered filed.

" 21. Petition for review to U. S. Circuit Court of Appeals (8) with assignments of error, filed by taxpayer.

Jul. 5. Proof of service filed.

Aug. 6. Praecipe with affidavit of service thereon filed.

" 6. Agreed statement of evidence lodged.

" 9. Agreed statement of evidence approved and ordered filed.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION OF THOMAS H. WELCH IN CAUSE No. 40852—Filed Oct. 1, 1928

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:B-8-RMJ-60D dated August 2nd, 1928, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual with principal office at 501 Forest Avenue South, Minneapolis, Minnesota.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on August 2nd, 1928.

3. The tax in controversy is income tax for the calendar year, 1926 and in the sum of $419.70.

[fol. 5] The determination of tax set forth in said notice of deficiency is based upon the following error:

The Commissioner of Internal Revenue erred in his ruling "that the amounts paid to former customers who lost money in a Company of which you were an officer are in the nature of gratuities and are not an ordinary and necessary expense of operation as provided by Section 214 (a) (1) of the Revenue Act of 1926".

5. The facts upon which the petitioner relies as a basis for this proceeding are as follows:

The tax payer and his father, Mr. E. L. Welch owned and operated a grain commission company under the name of E. L. Welch Company. The tax payer, during his connection with the E. L. Welch Company, induced various grain dealers to ship their grain to and otherwise trade with the E. L. Welch Company.

That during the year 1922, the E. L. Welch Company was declared bankrupt and large losses were sustained by the customers of the said Company. The customers secured through the direct solicitation and influence of the tax payer lost approximately $170,000.00. The tax payer felt morally bound to reimburse them as soon as his ability permitted, and each year since said bankruptcy, has paid out all his earnings except necessary living expenses to such customers.

During the year 1926, tax payer paid the sum of $12,651.95 to such customers because he felt morally obligated to reimburse them. That the said payments amounting to $12,651.95 were deducted from tax payer's gross income for the year 1926.

6. Wherefore, petitioner prays that this Board may hear the proceedings and review the determination of the Commission and that the petitioner be allowed to deduct the said sum of $12,651.95 from his gross income for the year 1926 in computing his individual income tax liability.

P. J. Coffey, Counsel for the Petitioner.

P. J. Coffey, 304 Yeates Building, Minneapolis, Minnesota.

Duly sworn to by Thomas H. Welch. Jurat omitted in printing.

[fol. 6] EXHIBIT "A" TO PETITION

Treasury Department, Washington

Office of Commissioner of Internal Revenue

IT:AR:B-8-RMJ-60D

August 3rd, 1928.

Mr. Thomas H. Welch, 501 Forest Avenue South, Minneapolis, Minnesota.

SIR: In accordance with Section 274 of the Revenue Act of 1926 you are advised that the determination of your tax

liability for the years 1926 discloses a deficiency of $419.70 as shown in the attached statement.

This section of the law above mentioned allows you an appeal to the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter. However, if you acquiesce in this determination, you are requested to execute the inclosed Form X and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully, D. H. Blair, by C. N. Allen, Deputy Commissioner.

Inclosures: Statement, Form X 866; Form 882.

[fol. 7] Statement

IT:AR:B-8. RMJ-60D

Aug. 2, 1928.

In re Mr. Thomas H. Welch, 501 Forest Avenue South, Minneapolis, Minn.

Year	Deficiency in tax
1926	$419.70

Reference is made to the report of the Internal Revenue Agent in Charge at Minneapolis, Minnesota, and to your protest submitted under date of May 22, 1928.

Careful consideration has been accorded your protest in connection with the agent's findings. The adjustment recommended by the agent has been approved for the reason that this office holds that the amounts paid to former customers who lost money in a company of which you were an officer, are in the nature of gratuities, and are not an ordinary and necessary expense of operation as provided by Section 214 (a) (1) of the Revenue Act of 1926.

Since such gratuities do not come within the purview of Article 251 of Regulations 69, they cannot be allowed as deductions for contributions.

Tax reported on return	$ 4.47
Proposed deficiency	419.70
Liability stated on Form 866	$424.17

Payment of the deficiency should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

BEFORE UNITED STATES BOARD OF TAX APPEALS

ANSWER OF COMMISSIONER OF INTERNAL REVENUE IN CAUSE No. 40852—Filed Nov. 24, 1928

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

1. Admits the allegations contained in paragraph 1.
2. Admits the allegations contained in paragraph 2.
3. Admits the allegations contained in paragraph 3.

[fol. 8] 4. Denies the respondent erred in the manner alleged and set forth in paragraph 4.

5. Denies the allegations contained in paragraph 5.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: W. Frank Gibbs, Special Atty., Bureau of Internal Revenue.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION OF THOMAS H. WELCH IN CAUSE NO 51929—Filed Jan. 12, 1931

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:D-2-ILF-60D dated November 13th, 1930, and as a basis of his proceeding alleges as follows:

1. The petitioner is Thomas H. Welch, an individual, residing at 2209 Humboldt Avenue, South, Minneapolis, Minnesota.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on November 13th, 1930.

3. The taxes in controversy are income taxes for the calendar year 1924 and 1925 and for $235.46 and $1,051.60 respectively.

4. The determination of tax set forth in the said notice of deficiency is based upon the erroneous disallowance of $4,000.36 for 1924 and $11,968.20 for 1925, lawful deductions from gross income.

5. The facts upon which the petitioner relies as the basis for this proceeding are as follows:

[fol. 9] (a) The sums of $4,000.36 and $11,968.20 were paid out in 1924 and 1925 respectively to customers of the taxpayer from commissions earned by him on grain shipments to the company which employed the taxpayer to solicit such shipments in 1924 and 1925.

The disbursements amounting to $4,000.36 and $11,968.20 were made by the taxpayer to customers he had personally induced to ship grain to the firm of E. L. Welch and Company, founded by the taxpayer's father and owned in part by the taxpayer and only to such customers as had lost money, and to extent of their respective losses, as the result of the bankruptcy of said E. L. Welch and Company in a prior year.

These amounts were paid in recognition of the taxpayer's moral obligation to reimburse his customers for losses incurred by them through dealing with the taxpayer.

Wherefore, the petitioner prays that this Board may hear the proceeding and allow as deductions from gross income for 1924, the sum of $4,000.36 and for 1925, the sum of $11,968.20, as allowable expenditures.

P. J. Coffey, Counsel for Petitioner, 311 Medical Arts Building, Minneapolis, Minnesota.

Duly sworn to by Thomas H. Welch. Jurat omitted in printing.

[fol. 10] EXHIBIT "A" TO PETITION

Treasury Department

Office of Commissioner of Internal Revenue

NP-2-26

Nov. 13, 1930.

Mr. Thomas H. Welch, 2209 Humboldt Avenue South, Minneapolis, Minnesota.

SIR: You are advised that the determination of your tax liability for the years 1924 and 1925, discloses a deficiency of $1,287.06, as shown in the statement attached.

In accordance with Section 274 of the Revenue — of 1926, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, If You Do Not Desire To Petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; Whereas, If No Agreement Is Filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully, David Burnet, Commissioner, by W. T. Sherwood, Deputy Commissioner.

Enclosures: Statement, Form 882, Form 870.

[fol. 11] Statement

IT:AR:D-2. ILF:—60D

In re Mr. Thomas H. Welch, 2209 Humboldt Avenue South, Minneapolis, Minnesota

Tax Liability

Year	Corrected tax liability	Tax previously assessed	Deficiency
1924	$448.17	$212.71	$235.46
1925	1,307.90	256.30	1,051.60
Total	$1,756.07	$469.01	$1,287.06

An examination of your returns filed for the years 1924 and 1925 together with related schedules shows that you did not include in your gross business income amounts of $4,000.36 and $11,968.20, respectively, which represented payments made during the taxable years to old customers of E. L. Welch and Company, a dissolved corporation of which you and your father were the principal stockholders.

The company which was engaged in the grain commission business was incorporated under the laws of the State of Minnesota in 1906 with an authorized capital stock of $50,000.00. In the year 1922, the corporation was declared a bankrupt and final liquidation of the assets was made on July 2, 1926, the customers secured through your solicitation losing approximately $170,000.00.

After the dissolution of the corporation you entered into a similar business in your individual capacity. In reporting your gross income from business in the years 1924 and 1925, it appears that you omitted the respective aggregate amounts of $4,000.36 and $11,968.20, which represented payments in the nature of a partial reimbursement to customers of the defunct corporation, for which you felt morally bound, and which you, therefore, considered allowable deductions from business income in each year under the provisions of section 214 (a) (1) of the Revenue Act of 1926.

A careful consideration has been given the facts in the case. The amount of payment made by you to customers was apparently a new obligation since no agreement existed between you and the bankrupt corporation, or between you and the old customers of the corporation. The benefit anticipated from such payments was improved credit reputation and standing and was in the nature of capital expenditures which are not deductible as ordinary and neces- [fol. 12] sary expenses. In this connection your attention is directed to the decision of the United States Board of Tax Appeals in the appeal of the Herbert Brush Manufacturing Company, 15 B. T. A. page 673.

The computation of tax is as follows:

1924

Net income on return	$10,664.23
Add: Additional business income	4,000.36
Total net income	$14,664.59
Less: Personal exemption and credit for dependents	3,300.00
Amount subject to normal tax	$11,364.59

Normal tax at 2% on $4,000.00	$80.00
Normal tax at 4% on $4,000.00	160.00
Normal tax at 6% on $3,364.59	201.88
Surtax on $14,664.59 ($40.00+2% on $664.59)	53.29
Total tax	$495.17
Less: Earned income credit	47.00
Total tax assessable	$448.17
Tax previously assessed	212.71
Deficiency	$235.46

Computation of Credit on Earned Net Income

Earned net income	$10,000.00
Brought forward	$10,000.00
Less: Personal exemption and credit for dependents	3,300.00
	$6,700.00
Normal tax at 2% on $4,000.00	$80.00
[fol. 13] Normal tax at 4% on $2,700.00	108.00
Total tax	188.00
Credit of 25%	47.00

1925

Net income on return	$14,524.71
Add: Additional business income	11,968.20
Total net income	$26,492.91
Less: Personal exemption and credit for dependents	4,300.00
Amount subject to normal tax	$22,192.91

Normal tax at 1½% on $4,000.00	$60.00
Normal tax at 3% on $4,000.00	120.00
Normal tax at 5% on $14,192.91	709.65
Surtax on $26,492.91 ($440.00+7% of $2,492.91)	614.50
Total tax	$1,504.15
Less: Earned income credit	196.25
Total tax assessable	$1,307.90
Tax previously assessed	256.30
Deficiency	$1,051.60

Computation of Credit on Earned Net Income

Earned Net income	$20,000.00
Less: Personal exemption and credit for dependents	4,300.00
Balance	$15,700.00
Normal tax at 1½% on $4,000.00	$60.00
Normal tax at 3% on $4,000.00	120.00
Normal tax at 5% on $7,700.00	385.00
[fol. 14] Surtax on $20,000.00	220.00
Total tax	$785.00
Credit of 25%	196.25

Payment should not be made until a bill is received from the Collector of internal revenue for your district and remittance should then be made to him.

Consents which will expire December 31, 1930, except as extended by the provisions of section 277 (b) of the Revenue Act of 1926, are on file for the years 1924 and 1925.

BEFORE UNITED STATES BOARD OF TAX APPEALS

ANSWER OF COMMISSIONER OF INTERNAL REVENUE IN CAUSE No. 51929—Filed Feb. 5, 1931

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

1, 2 and 3. Admits the allegations in paragraphs 1, 2 and 3.

4. Denies the respondent erred as alleged and set forth in paragraph 4.

5. Denies the allegations in paragraph 5.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: W. Frank Gibbs, Special Atty., Bureau of Internal Revenue.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION OF THOMAS H. WELCH IN CAUSE No. 53119—Filed Feb. 24, 1931

[fol. 15] The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:D-1-CMS-60D, dated January 13th, 1931, and as the basis of his proceeding alleges as follows:

1. The petitioner is Thomas H. Welch, an individual residing at 2209 Humboldt Avenue South, Minneapolis, Minnesota.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on January 13th, 1931.

3. The taxes in controversy are income taxes for the calendar years 1927 and 1928 and for $546.83 and $819.37 respectively.

4. The determination of tax set forth in the said notice of deficiency is based upon the erroneous disallowance of $7,678.43 for 1927 and $11,150.00 for 1928, lawful deductions from gross income.

5. The facts upon which the petitioner relies as the basis for this proceeding are as follows:

(a) The sums of $7,678.43 and $11,150.00 were paid out in 1927 and 1928 respectively to customers of the taxpayer from commissions earned by him on grain shipments to the company which employed the taxpayer to solicit such shipments in 1927 and 1928. These disbursements were made by the petitioner to customers he had personally in-

duced to ship grain to E. L. Welch and Company, a corporation founded by the petitioner's father and owned in part by the petitioner and only to such customers as had lost money, and to the extent of their respective losses as the result of the bankruptcy of said E. L. Welch and Company in a prior year.

Wherefore the petitioner prays that this Board may hear the proceeding and allow as deductions from gross income for 1927, the sum of $7,678.43 and for 1928 the sum of $11,150.00 as allowable expenses.

P. J. Coffey, Counsel for Petitioner, 311 Medical Arts Building, Minneapolis, Minnesota.

Duly sworn to by Thomas H. Welch. Jurat omitted in printing.

[fol. 16] EXHIBIT "A" TO PETITION

Treasury Department, Washington

Office of Commissioner of Internal Revenue

NP-2-26-28

Address reply to Commissioner of Internal Revenue and refer to ——.

Jan. 13, 1931.

Mr. Thomas H. Welch, 501 Forest Avenue South, Minneapolis, Minnesota.

SIR: You are advised that the determination of your tax liability for the years 1927 and 1928 discloses a deficiency of $1,366.20 as shown in the statement attached.

In accordance with section 274 of the Revenue Act of 1926 and section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability for the years in which a deficiency is disclosed.

However, If You Do Not Desire To Petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your returns by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed [fol. 17] agreement, or on the date assessment is made, whichever is earlier; Whereas If No Agreement Is Filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully, David Burnet, Commissioner, by W. T. Sherwood, Acting Deputy Commissioner.

Enclosures: Statement, Form 882, Form 870.

Statement

IT:AR:D-1. CMS-60D

In re Mr. Thomas H. Welch, 501 Forest Avenue South, Minneapolis, Minnesota

Tax Liability

Years	Corrected tax liability	Tax previously assessed	Deficiency
1927	$849.49	$302.66	$546.83
1928	1,103.10	283.73	819.37
Totals	$1,952.59	$586.39	$1,366.20

The reports of the internal revenue agent in charge, St. Paul, Minnesota covering your tax liability for the years 1927 and 1928 have been reviewed by this office and approved as submitted.

The following adjustments have been made:

1927

Net income reported	$14,739.89
Add 1. Income from salaries	7,727.70
Adjusted net income	$22,467.59

[fol. 18] Computation of Tax

Net income adjusted	$22,467.59
Less: Personal exemption and credit for dependents	4,300.00
Balance subject to normal tax	$18,167.59
Normal tax at 1½% on $4,000.00	$60.00
Normal tax at 3% on $4,000.00	120.00
Normal tax at 5% on $10,167.59	508.38
Surtax on $22,467.59	348.06
Total tax	$1,036.44
Less: Credit on 25% of tax on earned net income	186.95
Tax liability	$849.49
Tax previously assessed	302.66
Deficiency in tax	$546.83

Explanation of Change

1. The amount reported as commissions received from Kellogg Commission Company was overstated by $241.33.

Included in the amount representing total expenses claimed as a deduction against salaries received was an item of $290.60, claimed for interest paid. This amount has been disallowed since it was also claimed as a deduction under item 11 of your return.

The amount of $7,678.43 claimed as a deduction against salaries received and explained as payments made to creditors of E. L. Welch Company, has been disallowed as not representing ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business as defined by section 214 (a) (1) of the Revenue Act of 1926.

1928

Net income reported	$15,109.31
Add: 1. Income from salary	11,150.00
Adjusted net income	$26,259.31

[fol. 19] Computation of Tax

Net income adjusted	$26,259.31
Less: Personal exemption and credit for dependents	4,300.00
Balance subject to normal tax	$21,959.31
Normal tax at 1½% on $4,000.00	$60.00
Normal tax at 3% on $4,000.00	120.00
Normal tax at 5% on $13,959.31	697.97
Surtax on $26,259.31	598.15
Total tax	$1,476.12
Less: Credit of 25% of tax on earned net income	373.02
Tax liability	$1,103.10
Tax assessed	283.73
Deficiency in tax	$819.37

Explanation of Change

1. This amount, representing payments made to creditors of E. L. Welch Company, and claimed as a deduction against salary received, has been disallowed as not coming within the provisions of section 23 (a) of the Revenue Act of 1928.

Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for the years 1927 and 1928 the Bureau will be unable to afford you an opportunity under the provisions of article 1211 of Regulations 69 and article 451 of Regulations 74 to discuss your case before mailing formal notice of its determination as provided by section 274 (a) of the Revenue Act of 1926 and section 272 (a) of the Revenue Act of 1928. It is, therefore, necessary at this time to issue this formal notice of deficiency.

[fol. 20] Form 870.

Treasury Department, Internal Revenue Service.
Revised October, 1930.
IT:C:P-7.

In re Mr. Thomas H. Welch, 501 Forest Avenue South, Minneapolis, Minnesota

Waiver of Right to File a Petition with the United States Board of Tax Appeals

The undersigned taxpayer hereby waives the right to file with the United States Board of Tax Appeals under Section 274 (a) of the Revenue Act of 1926, and/or Section 272 (a) of the Revenue Act of 1928, and consents to the assessment and collection of a deficiency in income tax for the

calendar year ended December 31, 1927 in the sum of $546.83
calendar year ended December 31, 1928 in the sum of $819.37
.....year ended .....in the sum of $.....

amounting to the total sum of $1,366.20

together with interest thereon as provided by law.

(Name:) —— ——, (Address:) ——, by —— ——.
Date: —— —, ——.

Note.—This waiver does not extend the statute of limitations for refund or assessment of tax, and is not an agreement as provided under Section 606 of the Revenue Act of 1928, but its execution and filing at the address shown in the accompanying letter will expedite the adjustment of your income tax liability as indicated above.

Where the taxpayer is a corporation, the agreement shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered to sign for the corporation, in addition to which the seal, if any of the corporation must be affixed.

[fol. 21] Before United States Board of Tax Appeals

Answer of Commissioner of Internal Revenue in Cause No. 53119—Filed Mar. 13, 1931

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Rev-

enue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

1, 2 and 3. Admits the allegations in paragraphs 1, 2 and 3.

4. Denies the respondent erred as alleged and set forth in paragraph 4.

5. Denies the allegations contained in paragraph 5(a).

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: W. Frank Gibbs, Special Attorney, Bureau of Internal Revenue.

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25 B. T. A. —

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 40852, 51929, 53119

THOMAS H. WELCH, Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Promulgated January 8, 1932

In order to re-establish his credit and to secure customers for his individual business from among those who had been customers of a corporation of which he was an officer, petitioner partially reimbursed those who had sustained losses when the corporation was discharged in bankruptcy. Held, that such amounts may not be deducted as "ordinary and necessary expense."

[fol. 22] Alexander E. Horn, Esq., and P. J. Coffey, Esq., for the petitioner.

C. H. Curl, Esq., for the respondent.

FINDINGS OF FACT AND OPINION

The respondent has asserted deficiencies in income taxes for the years 1924 to 1928, inclusive, in the respective amounts of $235.46, $1,051.60, $419.70, $546.83 and $819.37.

The single issue presented is whether, in the circumstances of these proceedings, the petitioner is entitled to deduct, as ordinary and necessary business expenses, certain amounts paid to reimburse creditors of a corporation, for losses sustained when the corporation was discharged in bankruptcy.

Findings of Fact

The petitioner is an individual residing in Minneapolis. During 1922, he was secretary of the E. L. Welch Company, a Minnesota corporation, engaged in the grain business. Except for 10 shares of stock owned by him, all the stock of E. L. Welch Company was owned by petitioner's father.

For several years prior to 1922, petitioner had been in close touch with the customers of E. L. Welch Company, having traveled through the territory for three or four months each summer making contacts with present and prospective customers. He handled all grain as it came in to Minneapolis, and attended to grading and sale. Petitioner's father looked after the financial end of the business only.

On March 23, 1922, the E. L. Welch Company was adjudged an involuntary bankrupt. The petitioner was adjudged a voluntary bankrupt on August 5, 1922. In due course each was discharged from existing debts. Shortly thereafter, the petitioner entered into a contract with the Kellogg Company, to purchase grain for it on a commission basis. In order to re-establish his standing and credit, and to revive new business contacts with former customers of the E. L. Welch Company, the petitioner determined, as far as he was able, to reimburse certain creditors of the E. L. Welch Company. Beginning in 1924, he made small payments to all of the numerous creditors, except two, by a special check which bore the following endorsement:

The payee of this check, by the endorsement hereof, accepts and agrees to apply the same on its claim against E. L. Welch Company, according to the terms of the letter of transmittal. It has nothing to do with present or future business relations with the maker of the check and is not to be considered as acknowledging any existing claim or renewing any barred claim against him.

[fol. 23] From 1924 to 1928, the petitioner earned commissions and made payments to reimburse creditors of the E. L. Welch Company as follows:

Year	Commissions	Credits of E. L. Welch Co.
1924	$18,028.20	$3,975.97
1925	31,377.07	11,968.20
1926	20,925.25	12,815.72
1927	22,119.61	7,379.72
1928	26,177.56	11,068.25

On his income tax returns for 1924, 1925 and 1926, the petitioner reported only the amount remaining from commissions earned after payments of the above amounts to creditors of the E. L. Welch Company. On his income tax returns for 1927 and 1928, he reported the total commissions received and deducted the payments to creditors of the E. L. Welch Company. The respondent has added to income the payments for 1924, 1925 and 1926, and has disallowed the deductions taken in 1927 and 1928.

Opinion

LANSDON:

We think the respondent correctly disallowed the deductions claimed. If the payments relate at all to "carrying on a trade or business" they still may not be allocated as expense of any particular year. Doubtless petitioner more quickly re-established his standing and credit and built up his new business by reimbursing those who had lost money through a corporation dominated by him and his father, but we do not understand payments of such a nature to be ordinary and necessary business expenses.

In two recent decisions we have held that the payment of discharged obligations for the purpose of re-establishing credit resulted in the acquisition of an intangible capital asset, in the nature of good will, which had a probable life co-extensive with the business. Herbert Brush Manufacturing Co., 15 B. T. A. 673; and A. Harris & Co., 16 B. T. A. 705. The latter case was reversed by the Circuit Court of Appeals for the Fifth Circuit in A. Harris & Co. vs. Lucas, 48 Fed. (2d) 187, and the deduction claimed was allowed. The facts of the instant proceeding are distinguished from those of the Harris case. There a mercantile

establishment, which had been discharged from its debts in a compromise settlement, reimbursed its former creditors in an effort to re-establish its credit so that it could buy without having to pay cash for each order. Here the [fol. 24] bankrupt corporation is no longer in business and an individual is seeking to build up a business by reimbursing creditors of the corporation who have lost money.

Decision will be entered for the respondent.

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 40852

THOMAS H. WELCH, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER OF REDETERMINATION—January 9, 1932

Pursuant to the determination of the Board, as set forth in its report promulgated January 8, 1932, it is

Ordered and Decided: That there is a deficiency of $419.70 for the year 1926.

Enter.

(Signed) W. C. Lansdon, Member.

Entered Jan. 9, 1932.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

(Seal.)

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

51929

THOMAS H. WELCH, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER OF REDETERMINATION—January 9, 1932

Pursuant to the determination of the Board, as set forth in its report promulgated January 8, 1932, it is

[fol. 25] Ordered and Decided: That there are deficiencies of $235.46 and $1,051.60 for the years 1924 and 1925, respectively.

(Signed) W. S. Lansdon, Member.

Entered Jan. 9, 1932.

A true copy. Teste:
B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 53119

THOMAS H. WELCH, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER OF REDETERMINATION—January 9, 1932

Pursuant to the determination of the Board, as set forth in its report promulgated January 8, 1932, it is

Ordered and Decided: That there are deficiencies of $546.83 and $819.37 for the years 1927 and 1928, respectively.

Enter.

(Signed) W. C. Lansdon, Member.

Entered Jan. 9, 1932.

A true copy. Teste:
B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 40852, 51929 and 53119 Consolidated for Hearing and Decision

[Title omitted]

PETITION OF THOMAS H. WELCH FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS—Filed June 21, 1932

The petition of the above named Thomas H. Welch respectfully shows:

[fol. 26] I

That on January 8, 1932 the above named United States Board of Tax Appeals promulgated its decision in the above entitled matter in favor of respondent and against petitioner and on January 9, 1932 said Board entered its order of redetermination that there are deficiencies in the income tax of petitioner for the years 1924 to 1928, both inclusive, payable by petitioner to respondent as follows:

For the year 1924	$235.46
" " " 1925	1,051.60
" " " 1926	419.70
" " " 1927	546.83
" " " 1928	819.37
Total	$3,072.96

II

Petitioner is and has been during all the times herein stated an inhabitant and also a resident of the City of Minneapolis and the State of Minnesota in the said Eighth Circuit and during said period during the years 1924 to 1928, both inclusive, made his annual return of his Federal income and excess profits tax to the Collector of Internal Revenue at said City of Minneapolis.

The United States Circuit Court of Appeals of the Eighth Circuit has jurisdiction to review said decision under Sections 1001, 1002, and 1003 of the Revenue Act of 1926, and a review of said decision and order of redetermination is sought by petitioner by the United States Circuit Court of Appeals of the Eighth Circuit.

III

The nature of the controversy is as follows:

E. L. Welch & Company, a Minnesota Corporation, with its principal place of business at the City of Minneapolis, engaged in business throughout the Northwest of buying and selling grain on commission, was adjudged an involuntary bankrupt on March 23, 1922. Its liabilities were about $500,000. It was discharged in 1926.

Petitioner was adjudged a voluntary bankrupt on August 25, 1922, and was discharged in October, 1922. The outstanding capital stock of the corporation at the time of the

adjudication was $50,000. Petitioner was secretary of the company and held one thousand dollars and his father, E. L. Welch, president and treasurer, held the balance of [fol. 27] the shares. The corporation handled a large volume of cash grain. The largest part of its business was handling grain on commission. Petitioner was in close touch with the customers and took complete charge of the grain as it came in. He also handled cash grain.

After the adjudication and in the years 1924 to 1928 inclusive, he was engaged in the same business as the corporation had been in and in the same territory and with some of its old customers—that is, selling grain on commission.

His gross income for these years was $118,818.41, which income was received as commission from sales of grain. Of this amount he paid an income tax on $71,610.55. He did not pay any income tax on the balance of $47,207.86—this amount he paid to the creditors of the corporation existing at the time of its adjudication in bankruptcy.

His gross income for each year was:

Years	A	B
1924	$14,052.23	$3,975.97
1925	19,408.87	11,968.20
1926	8,300.25	12,815.72
1927	14,739.89	7,379.72
1928	15,109.31	11,068.25
	$71,610.55	$47,207.86

Colum A represents amounts on which the income tax was paid and Column B the amounts paid to creditors of the corporation and on which no income tax was paid.

Petitioner in his income tax returns for the years 1924 to 1926, both inclusive, reported the amounts in Column A and in his returns for the years 1927 and 1928 reported the full amount of his earnings in Columns A and B. The motives of petitioner in making these payments to the creditors of the corporation (Column B) were to re-establish his standing and credit and build up new business. He then claimed and now claims that these payments (Column B) were, under Section 214 (a) Revenue Act of 1926, ordinary and necessary expenses paid during the taxable year

in carrying on his business and that the payments in each of the years in question were proper deductions in the year when made from his gross income of that year.

The determination of the Board was that these payments could not be considered a business expense but were a capital expenditure and not deductible from gross income but if they were a business expense they could not be allo- [fol. 28] cated as an expense in the particular year when made and for these reasons were not proper deductions from income but were taxable income.

IV

Assignments of Error

Your petitioner states that in said petition manifest errors were contained to his prejudice, that is to say the said United States Board of Tax Appeals erred:

1. In ordering the entry of judgment in favor of respondent.

2. In ordering and deciding that upon redetermination there was a deficiency in the amounts above stated for each of said years 1924 to 1928, both inclusive, and in sustaining respondent in disallowing the deductions claimed by petitioner for each of said years in the amount stated in Column B.

3. In ordering and deciding that the amounts paid to creditors of the corporation (Column B) for the years 1924 to 1928, both inclusive, and each of said years, were not an ordinary and necessary expense of carrying on the business of petitioner and were not proper deductions for any of said years from gross income for the reason that there is no evidence to support such a finding, and it being contrary to the evidence, and that the evidence conclusively and without contradiction established the fact that such payments in each of said years were ordinary and necessary expenses of carrying on the business of petitioner.

4. In holding and deciding that said payments (Column B) could not be allocated as an expense of any particular year when made for the reason that there is no evidence to support such a finding and it being contrary to the evidence and that the evidence conclusively and without contradiction established the fact that such payments in each

of said years were made as stated in Column B and a proper deduction from gross income in each of said years.

5. In refusing to hold that said payments (Column B) were ordinary and necessary expenses of carrying on the business of petitioner during each of said years and that the same could be properly allocated as an expense of each particular year on the ground that the evidence conclusively and without contradiction established that such was a fact.

6. In denying the motion of petitioner for judgment.

[fol. 29] Wherefore, Petitioner prays that said decision and order of redetermination by the United States Board of Tax Appeals in the above proceedings be reversed.

Dated this 7th day of June, 1932.

Alexander E. Horn, Attorney for Petitioner, 1116 Pioneer Building, St. Paul, Minnesota. Thomas H. Welch, Petitioner.

Duly sworn to by Thomas H. Welch. Jurat omitted in printing.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Numbers 40852, 51929 and 53119, Consolidated for Hearing and Decision

[Title omitted]

NOTICE OF PETITION FOR REVIEW AND ADMISSION OF SERVICE—Filed July 5, 1932

Please Take Notice that the petition for review of the petitioner in the above entitled matter, to the United States Circuit Court of Appeals for the Eighth Circuit has been filed with the Clerk of the above named United States [fol. 30] Board of Tax Appeals, a copy of which petition is hereto attached and herewith served upon you.

Dated June 22, 1932.

(Signed) Alexander E. Horn, Attorney for Petitioner, 1116 Pioneer Building, St. Paul, Minnesota.

Due service of the within Notice by true copy, and also service of the petition for review therein referred to is admitted at Washington, D. C., this 23rd day of June, 1932.

(Signed) C. M. Charest, Attorney for Commissioner of Internal Revenue.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Numbers 40852, 51929 and 53119, Consolidated for Hearing and Decision

THOMAS H. WELCH, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Statement of Evidence—Received Aug. 6, 1932; Lodged Aug. 6, 1932; Filed Aug. 9, 1932

Be it remembered that the above matter came on for hearing July 15th, 1931, before the Honorable William C. Lansdon, member of the United States Board of Tax Appeals, at St. Paul, Minnesota, Alexander E. Horn appearing on behalf of petitioner and C. H. Curl appearing on behalf of Respondent.

THOMAS H. WELCH, petitioner, was duly sworn as petitioner on his own behalf and testified as follows:

My age is forty-four years. I reside in Minneapolis, Minnesota. I was Secretary of E. L. Welch Company, a Minnesota corporation, in 1922. The outstanding capital stock was $50,000. I owned ten shares. The balance of the shares was owned by my father, E. L. Welch, who was President.

[fol. 31] The corporation was adjudged an involuntary bankrupt March 23, 1922, and discharged July 6, 1926.

I was adjudged a voluntary bankrupt August 5, 1922, and discharged October 25, 1922.

At the time of its adjudication in bankruptcy, and for some years prior thereto, this corporation handled a large volume of cash grain and other grain futures, what is known as grain business. The largest part of its business was handling grain on commission. I had charge of the

actual handling of the cash grain—commission business and also looking — future business. I was in very close touch with the customers of the corporation and travelled out in the country through the summer and fall three or four months, and then took complete charge of the grain as it came in, and handled the cash grain and practically loaded 85 or 90 per cent, in addition to cash sales, the details in regard to it, the grading of grain and trading and futures.

My father took charge of the financial business entirely.

After the bankruptcy, I engaged in the grain commission business, and did business in the same territory that the corporation had been doing business in.

The following is a statement each year of my gross income (Column A)—the amounts on which I paid an income tax (Column B), and the amounts I paid to the creditors of the corporation, and on which no income tax was paid (Column C):

	A	B	C
1924	$18,028.20	$14,052.23	$3,975.97
1925	31,377.07	19,408.87	11,968.20
1926	20,952.20	8,300.25	12,651.95
1927	22,119.61	14,739.89	7,379.72
1928	26,177.56	15,109.31	11,068.25
	$118,654.64	$71,610.55	$47,044.09

On his income tax return for 1924, 1925 and 1926 the petitioner reported only the amount remaining from the commissions earned after payments of the above amounts to creditors of E. L. Welch Company. On his income tax returns for 1927 and 1928 he reported the total commissions received and deducted payments to creditors of E. L. Welch Company. The respondent has added to income the payments for 1924, 1925 and 1926 and has disallowed deductions taken in 1927 and 1928.

[fol. 32] The creditors were paid by my checks, mailed with letter of transmittal, and each check had the following endorsement:

"The payee of this check by the endorsement thereof accepts and agrees to apply the same on its claim against E. L. Welch Company according to the terms of the letter of transmittal. This has nothing to do with present or future business relations with the maker of the check and

is not to be considered as acknowledging any existing claim or renewing any barred claim against him."

The payments made to creditors in 1924 were made to practically all of the creditors of the corporation and included shippers of cash grain and future trade balances and bank paper, and also small bills such as for water and printing bill, and so forth. In fact they were all paid. Every creditor in excess of $25 was paid $25, and every creditor up to $25 was paid in full. The purpose of that was to get rid of small accounts as far as I could.

Of the amounts I paid to creditors in 1924, the sum of $1,226.58 represents claims that were paid in full. I took an assignment of these claims because the corporation was still in bankruptcy. No assignment was taken for the balance of the payments.

My checks were sent out in the same manner and with the same endorsement in 1925. The payment to each creditor was $100. These creditors were practically the same who received payments in 1924—with a few exceptions and some additions. All of the small accounts were paid in full in 1924.

Of the amounts paid to creditors in 1925 I took assignments of claims amounting to $1,228.20, but did not take any assignments for the balance.

Checks were sent out in the same manner and with the same endorsement in 1926, 1927 and 1928, and no assignments were taken for any part of the claims for any of these years.

All of the payments in 1924 to 1928, inclusive, were payments made to creditors of the corporation existing at the time of its adjudication in bankruptcy.

These payments included claims of the following banks, namely: First National Bank of St. Paul; Midland National Bank, Minneapolis; Manufacturers National Bank, Minneapolis; City National Bank, Duluth; First National Bank, [fol. 33] LeSeuer, Minnesota; Staple County Bank of Henderson, Minnesota, and the Security State Bank of Shakopee, Minnesota, and these payments to these banks included practically all of the bank creditors of the corporation.

The claims against the corporation amounted to about $500,000 and the claims of creditors to whom I made the payments amounted to about $300,000. The balance of

$200,000 was claims of the Security Elevator Company and the Carson Mill Company at Fairbanks. They were both indebted to the Welch Corporation at the time of its failure. I did not pay anything on these two claims because I did not consider that they were valid claims against the Welch Corporation.

A very large number of the creditors to whom I made payments were personal friends and customers of mine of long standing in the business.

Q. "Had they been induced in the first instance, while the corporation was a going concern to do business with the corporation on the strength of their acquaintance with you?"

A. "They had."

I talked to Mr. Jaffray, President of the First National Bank of Minneapolis before I went into bankruptcy and told him what my plan was, to pay the creditors in connection with the old company and my intention was to pay every legitimate claim, every valid claim. His advice was that if a man went through bankruptcy with the idea of beating his creditors and avoiding paying his just debts that all bankers considered him absolutely crooked, but if a man went through bankruptcy with the idea of getting a new start and making up his claims, that they considered him 100 per cent.

I went to three bankers and they all had the same opinion. I wanted to get away of going through bankruptcy if I could and that is why I went to them.

Q. "You found by following that advice that you were successful in your business thereafter, weren't you?"

A. "Yes, sir."

Q. "And you built up a large business, largely because you acted square with these creditors, isn't that a fact?"

A. "Yes, sir, to a certain extent."

Q. "Yes, and you are doing business today with a large number of them, aren't you?"

A. "A number of them, yes."

[fol. 34] Q. "What is the motive or reason for the payments that you made on these claims?"

A. "Well, it was to reestablish my credit for one thing, reestablish my business, and, further, it was a matter of a moral obligation."

I reported and disclosed in my income tax returns for 1924, 1925 and 1926 only the amounts in Column B because Mr. Carr, a tax expert in Mimeapolis, told me it was not necessary to report the amounts paid to creditors (Column C) and later on, I think it was about a year after the 1924 payment, he referred to a decision of the Tax Appeal Board made in the Herschel Jones case and said the decision fitted my case exactly. Mr. Carr made all my income tax returns and I gave him a complete statement of every dollar I earned in each of the years in question, and he made my income tax returns from this information. I sent in the returns the way he made them up.

Judgment for deficiencies was entered in favor of respondent, viz:

1924	$235.46
1925	1,051.60
1926	419.70
1927	546.83
1928	819.37
	$3,072.96

Petitioner's motion for judgment in his favor was denied.

STIPULATION RE STATEMENT OF EVIDENCE

It Is Stipulated that the foregoing statement of evidence contains all the evidence material to the assignment of errors, and may be settled by a member of the United States Board of Tax Appeals, without notice to either party.

Dated July 21, 1932.

Alexander E. Horn, Attorney for Petitioner. C. M. Charest, Attorney for Respondent. (S.)

[fol. 35] BEFORE UNITED STATES BOARD OF TAX APPEALS

APPROVAL OF STATEMENT OF EVIDENCE

Now, therefore, the foregoing statement of the evidence is approved and settled and ordered filed.

Dated Aug. 9, 1932.

W. C. Lansdon, Member of United States Board of Tax Appeals. (S.)

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Numbers 40852, 31929 and 53119, Consolidated for Hearing and Decision

[Title omitted]

PRECIPE FOR TRANSCRIPT—Filed Aug. 6, 1932

To B. D. Gamble, Clerk of the above U. S. Board of Tax Appeals:

Please prepare, certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit at St. Louis, Missouri, the following in the above entitled actions, namely:

1. Docket entry of proceedings before the Board.
2. All pleadings before the Board.
3. Findings of fact, opinion and decision of the Board.
4. Petition for review with admission of service and date of filing.
5. Statement of evidence as agreed on, approved and settled.

(Signed) Alexander E. Horn, Attorney for Petitioner, 1116 Pioneer Building, St. Paul, Minnesota.

[fol. 36] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 36a] Appearances of counsel omitted in printing.

[fol. 37] Minute entry of argument and submission, December 10, 1932, omitted in printing.

[fol. 38] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT, MARCH TERM, A. D. 1933

No. 9585

THOMAS H. WELCH, Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

On Petition to Review Decision of United States Board of Tax Appeals

Mr. Alexander E. Horn (Mr. Thomas D. O'Brien and Mr. Edward S. Stringer were with him on the brief), for petitioner.

Mr. J. P. Jackson, Special Assistant to the Attorney General (Mr. G. A. Youngquist, Assistant Attorney General, Mr. Sewall Key, Special Assistant to the Attorney General, Mr. C. M. Charest, General Counsel, Bureau of Internal Revenue, and Mr. Hugh Brewster, Special Attorney, Bureau of Internal Revenue, were with him on the brief), for respondent.

Before Stone, Van Valkenburgh and Booth, Circuit Judges

OPINION—Filed March 24, 1933

STONE, Circuit Judge, delivered the opinion of the court.

This is a petition to review a decision of the Board of Tax Appeals, affirming an assertation by the Commissioner of deficiencies in the income taxes of this petitioner for the years 1924 to 1928, inclusive.

The deficiencies are properly asserted unless the income for the involved years is to be reduced by certain payments [fol. 39] which the taxpayer contends are properly deductible business expenses. The character of these payments is as follows. Prior to and in the year 1922, petitioner was a minor stockholder and secretary of the E. L. Welch Company, a Minnesota corporation engaged in the grain marketing business. Petitioner was in close touch with the customers of this company and handled their grain coming into Minneapolis and attended to the grading and sale thereof there. In 1922, the company was adjudged an involuntary bankrupt, and later in the same year this petitioner was adjudged a voluntary bankrupt. In due course both the company and petitioner received discharges.

Thereafter, the petitioner entered into a contract with another company to purchase grain for it on a commission basis. In order to reestablish his standing and credit, and to revive business contacts with former customers of the Welch Company, the petitioner determined, as far as he was able, to reimburse certain creditors of that company for balances due after the discharge in bankruptcy of that company. Beginning in 1924, and continuing into 1928, he made payments to various of these creditors. It is these payments which he now claims as proper deductible business expenses. The question thus presented is purely one of law. Its solution depends upon a construction of the sections of the pertinent revenue statutes and the application of the undisputed situation here thereto. The statutes involved are Sections 214 (a) (1) of the Revenue Acts of 1924 and 1926 and Section 23 (a) of the Act of 1928. These sections contain identical provisions to the effect that the taxpayer may have as a deduction from gross income "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." The question is whether these expenses are "ordinary and necessary," within the meaning of the statute. Words used in a statute are to be taken in their usual, everyday meaning, and this is particularly true of revenue statutes (United States v. Kirby Lumber Co., 284 U. S. 1, 3; Woolford Realty Co. v. Rose, 286 U. S. 319). The deductible expenses must be both "necessary" and "ordinary" (Lloyd v. Commissioner, 55 Fed. (2d) 842, 844, C. C. A. 7). There may be room for argument and difference as to whether payments of this character, under the circumstances here, are "necessary," or not. It would be rather clear that they would be helpful in a business way and that helpfulness might approach or reach necessity. However, we can see no possible basis upon which payments [fol. 40] of this character can be treated, as "ordinary" expenses of his business (Robinson v. Commissioner, 53 Fed. (2d) 810, 811, C. C. A. 8, and see Lloyd v. Commissioner, 55 Fed. (2d) 842, C. C. A. 7, and Hubinger v. Commissioner, 36 Fed. (2d) 724, 726, C. C. A. 2). In fact, they are very extraordinary payments, and not expenses of the business at all. They are unlike the payments in Harris v. Lucas, 48 Fed. (2d) 187, C. C. A. 5, but are voluntary payments similar to those treated in Robinson v. Commissioner, 53

Fed. (2d) 810, 811, C. C. A. 8, and Mastin v. Commissioner, 28 Fed. (2d) 748, 753, C. C. A. 8. While these payments are highly commendable from an ethical standpoint, we are bound by the law as written.

The determination of the Board was correct and the petition for review must be and is dismissed.

[fol. 41] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

No. 9585

THOMAS H. WELCH, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

DECREE—March 24, 1933

On Petition to Review Decision of United States Board of Tax Appeals.

This cause came on to be heard on the petition to review a decision of the United States Board of Tax Appeals, affirming an assertation by the Commissioner of Internal Revenue of deficiencies in the income taxes of the petitioner for the years 1924 to 1928, inclusive, and was argued by counsel.

On Consideration Whereof, It is now here ordered, adjudged and decreed, by this Court, that the determination of the Board of Tax Appeals in this cause, be, and the same is hereby, approved and confirmed.

It is further ordered that the petition to review herein, be, and it is hereby, dismissed, without costs to either party in this Court.

[fol. 42] IN UNITED STATES CIRCUIT COURT OF APPEALS

PETITION FOR STAY OF MANDATE—Filed April 7, 1933

To the Honorable Judges of the Circuit Court of Appeals for the Eighth Circuit:

Thomas H. Welch, the above named petitioner, respectfully shows that on March 24, 1933, this Court duly entered its judgment and decree denying the petition herein to review the decision of the Board of Tax Appeals.

Your petitioner, feeling aggrieved by the decree of this Court, expects to apply to the Supreme Court of the United States for a writ of certiorari to review the judgment and decree of this Court.

The total amount of deficiencies assessed against your petitioner by the Board of Tax Appeals, and involved in this proceeding, is the sum of Three Thousand Seventy-two and 96/100 Dollars ($3,072.96), and the total interest thereon, at a very liberal estimate, does not exceed the sum of One Thousand Five Hundred Dollars ($1,500.00). At the time your petitioner filed his petition for review of the decision of said Board of Tax Appeals by this Court, your petitioner filed with said Board of Tax Appeals a bond in the sum of Eight Thousand Five Hundred Dollars ($8,500.00), a copy of which bond is hereto attached and marked Exhibit "A", and said bond is still in full force and effect. The surety on said bond was and is wholly solvent, and payment of any sum ultimately adjudged to be due from your petitioner is amply secured, and there is no need of further security as a condition to the stay of the mandate prayed for herein.

Wherefore, Your petitioner prays that the mandate in this cause from this Court to the Board of Tax Appeals be stayed pending petitioner's application to the Supreme [fols. 43-48] Court of the United States for a writ of certiorari.

Thomas H. Welch, by E. S. Stringer, his Attorney.

Duly sworn to by E. S. Stringer. Jurat omitted in printing.

Exhibit "A" to petition for stay omitted in printing.

[fol. 49] [File endorsement omitted.]

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER STAYING ISSUANCE OF MANDATE—April 7, 1933

Thomas H. Welch having filed herein his petition representing that he expects to apply to the Supreme Court of the United States for a writ of certiorari to review the judgment and decree of this Court, and praying that the mandate herein be stayed, it is

Ordered, that the issuance of a mandate in this cause to the Board of Tax Appeals be and the same hereby is stayed for a period of thirty (30) days beyond the time when, under the rules of this Court, a mandate would in due course issue, that is to say, that the mandate herein be and hereby is stayed until and including May 23, 1933.

Provided, however, that if, within such stay, there is filed with the Clerk of this Court the certificate of the Clerk of the Supreme Court of the United States that the certiorari petition, record and brief have been filed and proof of notice thereof under the rules of the Supreme Court, such stay [fol. 50] shall continue until final disposition by the Supreme Court. Upon filing of a copy of an order of that Court denying the writ, the mandate shall issue forthwith.

[fol. 51] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 52] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed May 22, 1933

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 37,602. U. S. Circuit Court of Appeals, Eighth Circuit. Term No. 33. Thomas H. Welch, petitioner, vs. Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed April 24, 1933. No. 33, O. T. 1933.

FILE COPY

FIL
APR 24
CHARLES ELM

Supreme Court of the United States

OCTOBER TERM, 1932.

No. [redacted] 33

THOMAS H. WELCH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

THOMAS D. O'BRIEN,
ALEXANDER E. HORN,
EDWARD S. STRINGER,
Counsel for Petitioner,
St. Paul, Minn.

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Supreme Court of the United States

OCTOBER TERM, 1932.

No. .....

THOMAS H. WELCH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

MAY IT PLEASE THE COURT:

The petition of Thomas H. Welch respectfully shows:

A.

SUMMARY STATEMENT OF MATTER INVOLVED.

Petitioner was a stockholder and managing officer of E. L. Welch Company. This corporation was adjudged a bankrupt in 1922, and in due course discharged. The business of the corporation had been handling grain on commission. In 1924,

petitioner entered the same line of business on his own account, dealing with the customers of the old corporation. In order to re-establish his credit, which had been damaged by the failure of the corporation, and to build up his business, petitioner, in each of the taxable years 1924 to 1928, inclusive, made payments to creditors of E. L. Welch Company of all or a part of their claims. By so doing, he was able to do a substantial business during these years, upon which the Government has been paid a tax. Each year petitioner claimed as a deduction for income tax purposes as one of his "ordinary and necessary expenses" in carrying on his business, the amounts paid during such year to the creditors of the old corporation.

The Commission disallowed the deductions, the Board of Tax Appeals sustained him, and the Circuit Court of Appeals for the Eighth Circuit sustained the Board of Tax Appeals.

The sole question involved is one of law, i. e., whether such payments to creditors of E. L. Welch Company, under such circumstances, were proper deductions for income tax purposes as "ordinary and necessary expenses" of petitioner's business.

B.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

I.

Because the decision of the Circuit Court of Appeals is in direct conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit on the same matter in *Harris vs. Lucas*, 48 Fed. (2nd), 187.

II.

Because the Circuit Court of Appeals decided an important question of Federal law which has never been specifically settled by this Court.

III.

Because the Circuit Court of Appeals decided said question erroneously and in a way in conflict with the apparent view of this Court in *Kornhauser vs. United States*, 276 U. S. 145.

C.

PRAYER FOR WRIT.

WHEREFORE, petitioner prays that a writ of certiorari be issued by this Court, directed to the United States Circuit Court of Appeals for the Eighth Circuit, commanding that Court to certify to this Court, for its review, a transcript of the record in case numbered and entitled on its docket No. 9585, *Thomas H. Welch*, Petitioner, vs. *Commissioner of Internal Revenue*, Respondent, and that said judgment of the Circuit Court of Appeals be reversed, and that petitioner have such other relief as may be proper.

Respectfully submitted,

THOMAS D. O'BRIEN,
ALEXANDER E. HORN,
EDWARD S. STRINGER,
Counsel for Petitioner,
St. Paul, Minn.

Supreme Court of the United States

OCTOBER TERM, 1932.

No. .....

THOMAS H. WELCH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

THE OPINIONS OF THE COURTS BELOW.

The opinion of the Board of Tax Appeals (R. 21-24) is dated January 8, 1932, and is reported in *Welch vs. Commissioner of Internal Revenue,* 25 B. T. A. 117. The opinion of the Circuit Court of Appeals for the Eighth Circuit is dated March 24, 1933 (R. 39-40), and is not yet reported, *Welch vs. Commissioner of Internal Revenue,* —— Fed. (2nd), ——.

II.

(1) The jurisdiction of this Court is based upon Section 240 of the Judicial Code of 1911, as amended by Act of February 13, 1925 (43 Stats. L. 938, Section 347, Title 28, United States Code).

(2) The date of the judgment sought to be reviewed is March 24, 1933 (R. 41).

(3) Nature of case and rulings below.

(a) The Board of Tax Appeals held that payments made by petitioner to creditors of a corporation of which he had been an officer and stockholder, which debts had been discharged by bankruptcy prior to their payment, were not "ordinary and necessary expenses" of petitioner's business (R. 21-24).

(b) The Circuit Court of Appeals sustained the Board of Tax Appeals in so holding, and dismissed the petition for review (R. 39-41).

III.

STATEMENT OF CASE.

Petitioner had been a managing officer and stockholder of a corporation engaged in handling grain on commission. He and his father were the sole active managers, and, while petitioner's own stockholdings were relatively small, his father owned the entire balance of the stock, and by reason of the name of the corporation (E. L. Welch Company) it was closely associated with petitioner in the public mind. Petitioner was the active outside man who made all the contacts with the customers, and attended to the grading and sale of the grain (R. 30-31).